

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 243 of 1985

and

INCOME TAX REFERENCE No 243-A of 1985

For Approval and Signature:

Hon'ble CHIEF JUSTICE MR DM DHARMADHIKARI

and

Hon'ble MR.JUSTICE M.S.SHAH

- =====
1. Whether Reporters of Local Papers may be allowed : NO
to see the judgements?
 2. To be referred to the Reporter or not? : NO
 3. Whether Their Lordships wish to see the fair copy : NO
of the judgement?
 4. Whether this case involves a substantial question : NO
of law as to the interpretation of the Constitution
of India, 1950 of any Order made thereunder?
 5. Whether it is to be circulated to the Civil Judge? : NO

COMMISSIONER OF INCOME-TAX

Versus

SHAHIBAUG ENTERPRENUERS PVT. LTD.

Appearance:

MR BB NAIK with MR MANISH R BHATT for Petitioner

MR RK PATEL for Respondent No. 1

CORAM : CHIEF JUSTICE MR DM DHARMADHIKARI

and

MR.JUSTICE M.S.SHAH

Date of decision: 08/03/2001

COMMON CAV JUDGEMENT

(Per : MR.JUSTICE M.S.SHAH)

In these references at the instance of the revenue, the following common questions have been referred to us under Section 256(2) of the Income-tax Act, 1961 (hereinafter referred to as "the Act") in respect of assessment years 1970-71 and 1974-75 :-

1. Whether on the facts and in the circumstances of the case, no question of assessing profits under sec. 41(2) of the Income-tax Act, 1961 in the hands of a holding company arises in case of sale by a holding company as a going concern to its 100% subsidiary company ?

2. Whether on the facts and in the circumstances of the cases, the AAC was right in setting aside the assessment and requiring the Income-tax Officer to reframe the assessment ?

2. The facts leading to Income-tax Reference No. 243-A, briefly stated, are as under :-

2.1 Karamchand Premchand Pvt. Ltd. (hereinafter referred to as "KPP") was a Private Limited Company which maintained its accounts on the basis of the financial year ending 31st March and on that basis its assessments were completed upto A.Y. 1973-74. KPP was amalgamated with Shahibaug Entrepreneurs Pvt. Ltd. (hereinafter referred to as "SEP" or "the assessee") with effect from 1.1.1974.

2.2 On 30.3.1970 the assessee sold the Wadala unit of one of its divisions called Swastik Oil Mills to Vegoll Pvt. Ltd., a wholly owned subsidiary of the assessee for a consideration of Rs. 1 Crore. This was made up of Rs.7.55 lacs for land and building, Rs.6.45 lacs for plant and machinery at book value and Rs.10 lacs for technical knowledge etc. and Rs.76 lacs for goodwill. The assessee did not declare any income chargeable to tax but the ITO included a sum of Rs.86 lacs relating to sale of technical knowledge and goodwill as profits from an adventure in the nature of goodwill. He further held that as the fixed assets were sold at WDV there was no profit under section 41(2).

2.3 In appeal, the AAC held that all the relevant facts for the purpose of determining the profits from an adventure in the nature of trade and the balancing charge under section 41(2), if any, not having been determined

by the ITO, the matter was required to be remitted to him for giving an opportunity to the assessee to place on record relevant material and contentions having regard to the various aspects of the controversy. The AAC accordingly set aside the assessment.

2.4 In appeal before the Income-tax Appellate Tribunal (hereinafter referred to as "the Tribunal") by majority of 2:1 the Tribunal held by its decision dated 4.1.1982 that as there was a slump sale, there was no question of assessing the profits under Section 41(2) of the Act and secondly that since there was no scope for including the total income in the income by way of balancing charge under Section 41(2), the AAC was not justified in setting aside the assessment. Hence, at the instance of the revenue, Reference No. 243-A of 1985 arises from the aforesaid decision of the Tribunal in respect of A.Y. 1970-71.

3. As far as Income-tax Reference No. 243 of 1985 is concerned, the same relates to assessment of SEP-assessee in respect of KPP for the previous year corresponding to the period from 1.4.1973 to 31.3.1974 in background of the following facts :-

3.1 The assessee was carrying on business as a proprietor of a number of industrial undertakings which were described as divisions. With effect from 30.6.1973 the assessee sold, by separate transactions, six of its divisions to four different Companies, all of which were wholly owned subsidiaries of the assessee, the particulars of which are given hereinafter. In all these four cas.....T.....T.....J

the assets including the goodwill of the respective businesses alongwith the liabilities of the respective divisions with effect from 30.6.1973. The value of the goodwill was not shown in the accounts and the balance-sheets of any of the undertakings, but a firm of the Chartered Accountants of the assessee determined the goodwill of each division as per the particulars given hereinafter. Adding the value of the goodwill to the value of the assets shown in the balance-sheet and deducting from the total amount, the liabilities as shown in the balance-sheet as at 30.6.1973, the consideration was determined for sale of each division.

3.2 The particulars of the sale of the aforesaid divisions to four different wholly owned subsidiary Companies of the assessee are as under :-

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Sr. No.	Division (undertaking)	Transferee Company (wholly transferred owned subsidiary by assessee Company of assessee)	Consideration Rs.(approx.)	Value of goodwill determined by assessee	Value of good as per assess
f Balancing					
ill charge					
ent					
order					
				Rs.	
Rs.	Rs.				

(a)	(b)	(c)	(d)	(e)	
(f)	(g)				

& Ind. Products
Pvt. Ltd.

2	Sarabhai Chemicals	Sarabhai Chemicals	6.95 Crores	7.50 Crores	4.34Cr
res 3.40 Crores					
	Sarabhai Common P. Ltd.				
	Service Dvn.				
	Sarabhai Mktg. Dvn.				
3	Sarabhai Machinery Fabriquip Pvt.Ltd.		1.36 Crores	40 lacs	Nil
4	Sarabhai Glass Dvn Packart Pvt. Ltd.		54 lacs	10 lacs	03.60 lacs

3.3 All the above transactions were with effect from 30.6.1973. The assessee did not offer any income as chargeable in its assessment for A.Y. 1974-75 in relation to the aforesaid transactions. The ITO, however, held that in respect of each transaction there was a chargeable income which was includible in the assessment. The ITO firstly held that on sale of Swastik Oil Mills there was an adventure in the nature of trade and that the business did not have any goodwill and, therefore, the amount of Rs.2 crores (determined as goodwill of the business) was charged under the head "business income" being income from an adventure in the

nature of trade.

He further held that the value of the goodwill of the business of the other undertakings was not as much as adopted by the assessee and to that extent the consideration had passed on the fixed assets, stocks, spare parts etc. Thus, as against the value of goodwill of all the divisions (other than Swastik Oil Mills) as adopted by the assessee at Rs.8 Crores (Rs.7.5 crores + Rs.40 lacs + Rs.10 lacs), the ITO estimated the total value of goodwill at Rs.4,37,60,000/- (Rs.4.34 crores + Nil + Rs. 3.60 lacs respectively). Thus, according to the ITO, the balance amount of Rs.3,62,40,000/- (i.e. Rs. 8 crores - Rs.4,37,60,000/-) was paid for transfer of assets for which depreciation had been allowed in the assessments for earlier years and for transfer of stocks, spare partes etc. As a result, the ITO included in the assessment certain incomes by way of balancing charge under section 41(2) and certain other income as realized from sale of stocks, spare parts etc. Thus, the income by way of balancing charge was determined at Rs.3,60,48,375/- and the income from business chargeable an on sale of stocks, spare parts, etc. were determined at Rs.1,91,625/-.

3.4 The assessee filed an appeal before the AAC disputing the additions made by the ITO. As regards the transaction of transfer of Swastik Oil Mills, the AAC held that there was no justification for holding that there was income from from an adventure in the nature of trade. As regards the sale of other divisions, the AAC tested the correctness of the estimate of the value of goodwill of the business in each case and marketing value of the other assets which were transferred to the purchasers. The AAC was of the view that income by way of balancing charge taxable under section 41(2) and relating to profit arising from sale of stock was includible in the assessment, but for this purpose inquiry as to the valuation of goodwill and the other aspects was necessary. The AAC observed that it was necessary to hold this inquiry because a part of the total amount of consideration had not passed for transfer of goodwill but had passed for transfer of capital assets and the stocks. The AAC accordingly set aside the assessment and restored the matter on the file of the ITO for making a fresh assessment order after carrying out the inquiries in light of the order of the AAC.

3.5 The assessee file a second appeal before the Tribunal. In this appeal also, the Tribunal by a majority of 2:1 held in favour of the assessee on both

the points i.e. the Tribunal held that since the transaction in question was a case of slump sale of each of the divisions as a going concern, there was no question of assessing the profits under Section 41(2) in the hands of the assessee (a holding Company) to its 100% subsidiary Company. In this view of the matter, the Tribunal, by a majority of 2:1, held that the AAC was not right in setting aside the assessment and in requesting the ITO to reframe the assessment after holding inquiries regarding the value of the goodwill and the other assets. From the aforesaid decision dated 4.1.1982 of the Tribunal based on the majority view, Income-tax Reference No. 243 of 1985 has been made under Section 256(2) of the Act at the instance of the revenue in respect of A.Y. 1974-75.

4. Since both the references pertain to the same assessee and raise common questions of law, with the consent of the learned counsel for the parties, the two references were heard together and are being disposed of by this common judgment.

5. We have heard Mr BB Naik, learned counsel for the revenue, instructed by M/s M.R. Bhatt & Co. We have also heard Mr RK Patel, learned counsel for the assessee. Both the learned counsel have taken us through the assessment order, the order of the Appellate Assistant Commissioner and the judgments of all the three learned Members of the Tribunal. The learned counsel have also invited our attention to the copies of the agreements regarding the aforesaid transactions of sale of the respective divisions.

6. Mr BB Naik, learned counsel for the revenue has made the following submissions :-

(i) As far as the sale of Swastik Oil Mills division is concerned, the assessing officer was justified in holding that it was an adventure in the nature of trade and, therefore, it did not have any goodwill. In any view of the matter, the division could not have any goodwill as it was incurring losses for the last five years and, therefore, it could not have had any goodwill. It is apparent that when such an undertaking with land and building, plant and machinery, stocks and raw material was sold at Rs.2.45 Crores, the value of the goodwill could not have been Rs.2 Crores. The ITO was justified in assessing the value of the goodwill at Nil.

- (ii) In respect of the other undertakings also the ITO was justified in holding that the goodwill was grossly overvalued at Rs. 8 Crores (Rs.7.5 crores + Rs.40 lacs + Rs.10 lacs) and that the ITO was justified in valuing the goodwill at Rs.4,37 Crores (to be precise Rs.4,37,60,000/-i.e. Rs.4,34,00,000 + Rs.3,60,000). Hence, the ITO had rightly added the remaining amount of Rs.3,62,40,000/- as the price paid for transfer of assets on which depreciation had been allowed in assessments for the earlier years and for transfer of stocks, spare-parts etc. together.
- (iii) The Tribunal erred in not appreciating that the assessee had valued the goodwill on the basis of the valuation report which applied the method of capitalization of future maintainable profits. Detailed submissions have been made for pointing out the errors in the valuation made by the valuer relied upon by the assessee.
- (iv) The controversy raised in these references is squarely covered by the decision of the Apex Court in CIT vs. Artex Manufacturing Co., (1997) 227 ITR 260.

7. On the other hand, MR RK Patel, learned counsel for the respondent-assessee has made the following submissions :-

I The provisions of Section 41(2) of the Act are not applicable to the transactions in question for the following reasons :-

- (a) Aggregate value of any asset is not equivalent to itemwise value of that particular asset.
- (b) Deeds of Assignment relating to all the transfers indicate only aggregate values of assets and in the corresponding schedules no itemwise value by way of break-up value of aggregate value is available.
- (c) All transfers are as going concerns by assessee, as a holding Company to 100% wholly owned Indian subsidiary companies and all assets are transferred at book value.

(d) The Tribunal's order, particularly the order of the third learned Member of the Tribunal, gives an undisputed finding of fact that the transactions are transactions of slump sales and each undertaking is sold as a whole. On this limited aspect, there is no difference of opinion between the Members of the Division Bench. The Tribunal further states that the appellant has not entered into sales of different items of the undertakings in question, but has sold the entire undertaking in each case. The parties have not put the valuation on the different assets and liabilities involved before coming to the net price in computing the slump price. Strong reliance has been placed on the decision of the Apex Court in CIT vs. Electrical Control Gear Mfg. Co., (1997) 227 ITR 278.

II The decision of the Apex Court in Artex Manufacturing Company (Supra) is not applicable for the following reasons :-

(a) The Apex Court has expressed the view that the provisions of section 41(2) are applicable in a case where a going concern is transferred and separate consideration for each item of properties sold is available, though there is no separate sale of different items. This is contrary to the factual situation existing in the assessee's case as stated above.

(b) In Artex case, it is an admitted position on facts that the assets had been the subject matter of revaluation by an authorized valuer at the time of agreement for sale whereas in the present case all assets are transferred at book value and no such exercise of revaluation of each item of all the assets was undertaken.

(c) In Artex case, though itemwise value attributable to each item of the total assets was not available at initial

stage, the same was available from the record before the Assessing Officer on the basis of information furnished by the assessee during the course of assessment and hence in the ultimate analysis price attributable to the items transferred was available on record. Therefore, the Hon'ble Supreme Court concluded that provisions of section 41(2) were applicable on the facts of that case, with particular reference to this aspect.

On the other hand in the instant case, no such information of itemwise value attributable to the aggregate value of asset was available at any stage right from inception and the same is not capable of being ascertained even as on today in absence of the same having been actually worked out at any time in the relevant Schedules appended to the corresponding Deed of Assignments read alongwith the relevant Minute Books of the concerned companies.

(d) Alternatively and without prejudice to the aforesaid contention, even assuming that the charge is fastened or the charge fructifies on principle, the actual machinery for computation fails in arithmetical terms. This is because of absence of any itemwise value of actual cost as well as written down value of the items of each asset in the Schedules to the Deed of Assignments. Practical difficulty will arise in arriving at arithmetical value being difference between actual cost and written down value of each item of assets for charging the same as income u/s. 41(2) because of several important factors like varying rates of depreciation for different assets. Strong reliance is placed on the decision of the Apex Court in Sunil Siddharthbhai vs. CIT, (1985) 156 ITR 509.

III Lastly, in any case, the taxable event is applicable only to the building, machinery, plant and furniture and, therefore, no other assets can be included within the scope of section 41(2) for

taxability of difference between written down value and the actual cost.

8. Before dealing with the rival contentions, it will be necessary to make a brief reference to the findings given by the Income-tax Officer in the assessment order, by the Assistant Appellate Commissioner in appeal and by the Members of the Tribunal regarding valuation of the goodwill as the said findings would assume considerable importance while deciding the rival contentions.

9.0 FINDINGS GIVEN BY THE ITO

9.1 Swastik Oil Mills Ltd. was a separate Company from 1930 onwards and it was under the managing agency of Sarabhai Sons (P) Ltd., a sister concern of the assessee. Earlier the shares of Swastik Oil Mills Ltd. were held by three groups including Sarabhai group and as per the agreement of the shareholders, all the shares of Swastik Oil Mills Ltd. came to be purchased by Sarabhai group i.e. by Sarabhai Sons (P) Ltd. The shares were purchased for a price which was higher than the value obtained on break up value method. The assessee company agreed to take over the entire share capital of Swastik Oil Mills Ltd. Sarabhai Sons (P) Ltd. which was holding all the shares of Swastik Oil Mills Ltd. agreed to sell its entire shareholding to the assessee Company on 15.4.1968. Upon purchase of Swastik Oil Mills Ltd., the same was amalgamated with the assessee Company and became one of the divisions of the assessee Company. Swastik Oil Mills Ltd. had two units, one at Wadala manufacturing vegetable oils and the other at Ambernath manufacturing detergents and cosmetics. Simultaneously, the assessee Company also floated a new wholly owned subsidiary Vegoils (Pvt.) Ltd. in July, 1968 itself with an authorized share capital of Rs. 1 Crore and subscribed whole of the share capital. At the end of the accounting year 1969-70, the assessee Company sold Wadala unit of its Swastik Oil Mills division to its newly floated wholly owned subsidiary Vegoil (Pvt) Ltd. for a consideration of Rs. 1 Crore which had the following break up :-

Particulars	Amount (Rs.)
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Land, building, plant & machinery	14,00,000/-
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Technical know-how	10,00,000/-
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Goodwill 76,00,000/-

The Ambernath unit of Swastik Oil Mills manufacturing detergents and cosmetics etc. was sold by the assessee to its newly floated wholly owned subsidiary Swastik Household & Industrial Products (P) Ltd. on 30.6.1973 for a sale consideration of Rs.2.45 Crores (which included goodwill of Rs. 2 Crores).

9.2 In support of its claim for goodwill of Rs. 2 Crores, the assessee filed a valuation report dated 25.6.1973 of Sorab S. Engineers & Co. The report valued the goodwill on capitalization of future maintainable profits. The ITO did not accept the said valuation report on the following grounds :-

- (a) The profit and loss account of Swastik Oil Mills division shows a huge loss of Rs.54.97 lakhs during the past 5 years while the valuation officer tries to imagine future profits of Rs. 607 lakhs.
- (b) The Swastik Oil Mills Division had previously been owned by Swastik Oil Mills Ltd. since 1930 and it had never shown any prosperity as imagined by the valuer prior to its amalgamation with the assessee Company.
- (c) When the Swastik Oil Mills Ltd. was incurring losses it was sold to the assessee by its shareholders.
- (d) Even after the assessee assumed its control it could not make any profits and it incurred losses to the tune of Rs.54.92 lakhs as stated above.
- (e) As discussed above, the Swastik Oil Mills had two divisions - one of its divisions i.e. Wadala Unit has already been sold by the assessee in the accounting year 1969-70 to Vegoils (P) Ltd. and a goodwill of Rs.76,00,000/- had already been charged. When a goodwill of Rs.76,00,000/- had already been charged then where is the possibility of any further goodwill and that too to the extent of Rs. 2 Crores ?
- (f) Goodwill in its present form means the

business is better than normal return of profitability. But here the case is reverse. So there is no goodwill. The business is also not of a monopolistic nature.

(g) It is pertinent to mention here that the Swastik Oil Mills division was sold to Swastik Household and Industrial Products (P) Ltd. on 30.3.1973 whereas the above valuation report is dated 25.6.1975. It means whole of the story of goodwill is an after thought cooked up story to show the real profits in the garb of so-called goodwill so that it can be claimed as a capital receipt from the subsidiary of the assessee Company.

Thus, there is no goodwill at all attached to the business of the Swastik Oil Mills division as claimed by the assessee.

9.3 The ITO gave notice dated 9.3.1977 to the assessee to show cause why the so called goodwill of Rs. 2 Crores charged in the sale consideration of the Ambernath unit of Swastik Oil Mills division to Swastik Household and Industrial Products (P) Ltd. on 30.6.1973 should not be taxed as business income from an adventure in the nature of trade on the aforesaid grounds. The assessee submitted its objections dated 14.3.1977. After considering the objections, the ITO held that there was no justification for valuing the goodwill at Rs. 2 Crores. After charging the so called goodwill of Rs. 2 Crores, it was credited to the capital reserve in the balance sheet and then the assessee manipulated losses on the sale of shares of newly floated companies to its floated subsidiaries at less than 50% of their face value and squared up the amount credited in the capital reserve in the balance sheet drawn on 30.6.1973 but thereafter in the months of July and December, 1973, the assessee Company sold a large number of shares to other group Companies (most of them were purchased in the recent past) to its large number of newly floated wholly owned subsidiaries and manipulated the capital loss amounting to Rs. 10.51 Crores to square up the credit of Rs.10 crores by selling such shares to its floated subsidiaries at 50% of their face value. In this process, the assessee received a benefit to the extent of the above amount of so called goodwill but without causing any loss either to itself or to the subsidiary. Since the

The ITO noted that the transferees/wholly owned subsidiaries to which the shares were sold were floated only on 20/22.6.1973 pursuant to the Board of Directors' resolution dated 14.6.1973 and the assessee Company resolved to subscribe their entire share capital by resolutions passed by the Board of Directors of the assessee Company. The ITO noted that the valuation report dated 25.6.1975 obtained by the assessee from Sorab S. Engineer & Co., Chartered Accountants was not acceptable as the valuer had tried to value the goodwill on capitalization of future maintainable profits, but Sarabhai Machinery division had incurred losses amounting to Rs.3.05 lacs during the last 5 years. If the average of last 5 years was taken, then the loss came to Rs. 61 lacs. Hence, if the super profits method were to be adopted for valuation, the then goodwill would be negative. The ITO held that the valuation report was not acceptable for the same reasons for which the valuation report of the above valuer was not acceptable in respect of Swastik Oil Mills division. The ITO, therefore, came to the conclusion that the so called goodwill represented the appreciated value or the difference between the fair market value and written down value of the land, buildings, plant and machinery etc. of the above divisions and also the difference between the fair market value of raw-materials, stock-in-trade, stock-in-process, finished goods, spare parts, stores and other articles. The ITO also held that the valuation report of the private valuer suffered from the following defects :-

- (a) The valuer has not deducted the reasonable amount of managerial remunerations from the average profits.
- (b) The valuer has not made adjustment of non-recurring items of income, capital receipts on sale of assets, excessive provisions of past years written back etc. before arriving at the profits of 5 years.
- (c) The valuer has failed to made adjustments on account of depreciation and capital expenditure on scientific research in the profits.
- (d) In method II the valuer has taken the goodwill equal to 3 years purchase price. In this method if the average of 5 years profits is taken, the goodwill should

have been equal to two years purchase price only.

- (e) It is pertinent to mention here that the sale of the above divisions took place on 30.6.73 whereas the valuation report relied on by the assessee is dated 25.6.75. It means the assessee had already charged the amount of goodwill of Rs.7,50,00,000/- on the sale of above divisions but with a view to make its case goodwill pace it obtained the above just after 2 years of the sale.

If the above defects are removed from the computation of goodwill made by the valuer, the goodwill come only to Rs.4,34,00,000/-

9.4 The aforesaid amount was worked out by the ITO and placed in Annexure "A" to the assessment order by working out the average net profits after tax as taken by the valuer for Sarabhai Chemicals Division, Sarabhai Marketing Division and Sarabhai Common Services Division for the A.Y. 1974-75 as under :-

ANNEXURE 'A'

Sarabhai Chemicals Division
Sarabhai Marketing Division
Sarabhai Common Services Division

1) Average Net Profits after tax as taken by the valuer	Rs.	95,00,000/-
Less : Managerial remuneration	Rs.	2,50,000/-

Rs.	92,50,000/-	
 Average purchase price equal to 2 years	Rs.	1,85,00,000/-
 2) Super Profits		
Net average profits	Rs.	92,50,000/-
Multiple of 10 i.e. 10%	Rs.	9,25,00,000/-
Less : Net Worth	Rs.	2,42,00,000/-

Rs.	6,83,00,000/-	

3) Average purchase price Rs. 1,85,00,000/-

Add : Super profits Rs. 6,83,00,000/-

Rs. 8,68,00,000/-

Average Rs. 4,34,00,000/-

So goodwill is Rs.4,34,00,000/-

The ITO, therefore, came to the conclusion that the difference between the value of the goodwill claimed by the assessee at Rs. 7.50 Crores and the value of the goodwill as worked out by the ITO at Rs.4.34 Crores i.e. the balance amount of Rs.3.16 Crores included in the sale consideration was nothing but the difference between the fair market value on the one hand and the book value on the other hand of land, building, plant & machinery, raw materials, stock-in-trade etc. The same reasoning was applied by the ITO for working out the goodwill of Sarabhai Glass Division at Rs. 3.60 lacs as against the goodwill of Rs. 10 lacs as claimed by the assessee for sale consideration for Sarabhai Glass Division.

9.5 When the ITO gave show cause notice dated 11.1.1977, the assessee filed its reply dated 7.2.1977 contending that the sums involved in question were nothing but pure and simple capital receipts which arose as a result of transfer of capital assets by the assessee Company to its wholly owned subsidiaries and, therefore, there was no liability to tax in view of the provisions of Section 47 of the Income-tax Act. The sale consideration was supported by the valuation report made by a firm of Chartered Accountants.

Whenever there is a transfer of an undertaking by a parent Company to its wholly owned subsidiary, it is prevalent practice to transfer the assets at book value and not at the so called market value. In any view of the matter, the purchaser Company, subsidiary or holding Company, is entitled to depreciation only on the written down value of the assets to the vendor Company and not on any higher value.

At the meeting of the Central Direct Taxes Advisory Committee held on 5.8.1970 at New Delhi, it was suggested that there should be no balancing charges in such cases when the subsidiary Company is not allowed depreciation on the enhanced cost and that if the Company transfers the assets at the written down value,

the question of balancing charge could not arise.

Even in the circular No. 63 dated 16.8.1971 issued by the Central Board of Direct Taxes, it was clarified that in case of take over of the undertakings of the banks, there would be no liability of tax on the existing banks in respect of balancing charge under Section 41(2) of the Act and that when the undertaking is transferred as a going concern and the assets are transferred at their respective book values, the question of levying any balancing charges should not arise. The assessee claimed that the total sum of Rs.10 crores represented the value of the goodwill and was not required to be charged under Section 41(2) of the Act as balancing charge or as a business profit when what was sold was the entire undertaking in a nature of 4 divisions and not individual assets of those undertakings. The assessee also stated that it has no information about the market valuer of the assets.

9.6 After considering the aforesaid objections and negating them, the ITO placed the valuation of the goodwill as stated in the chart in para 3.1 of this judgment as worked out as per the details given in the annexure to the assessment order and which is reproduced in para 9.4 hereinabove. The Assessing Officer came to the conclusion that the assessee had tried to avoid furnishing the of the details called for in order to conceal the fair market value of its assets so as to prevent the difference between the fair market value and the books value of the assets other than goodwill as business profits or as balancing charge. The ITO also considered the minutes of the meeting of the Central Direct Taxes Advisory Committee held on 16.8.1971 and held that the same was applicable only where a parent company had transferred the assets at the written down value, but the said Committee had no occasion to discuss the situation where a Company transferred its assets to its subsidiaries at book value and charged huge amount of profits in the garb of so called goodwill. The Assessing Officer also held that the assessing Company is neither a banking Company nor has it amalgamated with a banking Company. Hence, circular NO. 63 dated 16.8.1971 was not applicable.

As regards the assessee's arguments that the certificate from M/s Sarob S. Engineers was obtained on 23.6.1973 on the basis of which entries were posted in the books of accounts of the concerned divisions, the ITO noted that it was considered in the course of the hearing that the valuation reports as produced before the ITO

were in fact dated 25.6.1975. The ITO accepted that the question of taxability of capital gains would not arise in view of the bar imposed in Section 47, but there is no prohibition in the statute in regard to the taxability of profits or business profits under Section 41(2) in case of transfer to subsidiary companies. The ITO then concluded as under :-

"To conclude, the charging as income in the hands of the assessee the profits, including profits u/s. 41(2) held to be arising to the assessee on sale of the various undertakings to the newly floated subsidiary companies is approved in view of the clear-cut observations and the principles enumerated by the Supreme Court in CIT vs. B.M. Kharwar, 72 ITR 603.

FINDINGS GIVEN BY THE APPELLATE ASSISTANT COMMISSIONER

10. In appeals, the Appellate Assistant Commissioner of Income-tax (hereinafter referred to as "the Assistant Commissioner" or "the AAC") delivered decision dated 13.1.1977 in respect of the assessment year 1970-71 and the decision dated 28.3.1978 in respect of the assessment year 1974-75. The Assistant Commissioner came to the conclusion that the sale of the units of Swastik Oil Mills did not constitute an adventure in the nature of trade. Since the questions referred to us do not refer to the said controversy, we do not detain ourselves in discussing the reasons which prompted the Assistant Commissioner to come to the said conclusion. Even at the hearing of these references, focus of controversy was whether the value of the goodwill as indicated by the assessee or as determined by the Assessing Officer is to be considered as representing profits under Section 41(2) which can be taxed. Under normal circumstances, goodwill being a capital asset is not taxable when the sale is to be subsidiary but after considering all the relevant evidence and circumstances and the arguments advanced on behalf of the assessee and the departmental representative, the Assistant Commissioner came to the broad conclusions in favour of the revenue on the following issues :-

"(i) the fallacy of creating a goodwill while other assets are transferred at book value or WDV especially when the transfer is to a subsidiary.

(ii) the motive behind creating the so called

goodwill which is primarily intended to circumvent the taxation laws and the consequent need for a through scrutiny as to whether it had been devised to escape taxation of profits u/s. 41(2) and other profits, and

- (iii) on the non acceptability of the arguments of the assessee that when an undertaking is sold as such the Income Tax Officer has no right to determine the profits on individual items of assets transferred.

The Assistant Commissioner noticed how the ITO had determined the goodwill of the units in question after pointing out the deficiency in the valuation of the goodwill as given by the assessee and the Assistant Commissioner gave the following detailed reasons for accepting the conclusion of the Assessing Officer that the assessee had over-valued the goodwill and that the accounts only appeared to justify that goodwill can not be astronomical figures created by the assessee and there was, therefore, a great need to probe into the calculation, the criteria adopted for calculation of the goodwill and even the basis figures to be adopted for calculation.

- "(i) The appellant Company did not wind up its business after the transfer of assets to be four subsidiaries. It continued to be investment Company. The entire business was not sold as one going concern, but to four subsidiaries.

- (ii) The assets were transferred at specified values.

- (iii) The more fact that portions of the industrial undertaking had been sold does not established that it was a slump sale. The facts of the case should also prove that there was a slump sale. Since in the present case the business of the assessee continued and that sales were by parts and tax specified values, the theory of slump sale not be accepted. The decision is the case facts of the case (vide para 12 in the appellate order of Sarabhai Sons Ltd.)

- (iv) The Supreme Court decision in the case of B.M. Kharwar (72 ITR 603) is an effective answer to the interpretation put forward by the assessee and hence his arguments relying on the decision of Mugneram Bangur and Co. can not be accepted.
- (v) The assessee's reliance on circular No. 63 issued by the Board in connection with assessment problems on nationalized banks can not have in view of the special provisions of the Banking Companies Act. The proceedings of the Taxation Advisory Council can not be binding as in the case of circulars.
- (vi) Goodwill by its definition is created at times of sale to an outsider and that is normally done as a last step after revaluing the market value of assets. It is some thing extra realised on sale over and above the book value of the assets. To create goodwill and that too on a sale to a subsidiary when other assets are sold at book value or WDV is more unusual and hence suspicious.
- (vii) The explanation that the inflated assets by creation of goodwill can common better financial or loan assistance is by itself not acceptable. In such cases the real worth of the assess is often looked into and not the goodwill. The real explanation is that the so called goodwill can be said to represent the appreciated value of the assets. In fact in the case of valuation of Wadala unit goodwill created by the assessee was including the enhanced value of lease hold land.
- (viii) There has been kaleidoscopic changes in the pattern of companies and the shareholdings and as well be discussed in the later paragraph the underlying motive in the reorganization was tax planning and avoidance. This leads to the obvious inference that the assessee wanted to avoid tax by transferring the assets at

book value and at the same time reap other benefits by creating the so called goodwill which really represented the enhanced value of assets, and at the same time it could avoid tax by resorting to this method of entry.

- (ix) The Income-tax Officer has therefore the right to examine the nature of the claim of goodwill and if it is found to be incorrect, he is justified in treating it or a portion of it as representing the enhanced value of other assets."

However, the Assistant Commissioner held that the Assessing Officer had committed mistakes in the calculation of the goodwill. By a general scheme of reorganization the assessee Company alongwith Kalindi Investments P. Ltd. (old Sarabhai M. Chemicals Ltd.) were decided upon to become investment companies and the family members of the Sarabhai transferred most of their shares to the mentioned main Companies or their subsidiary investment Companies. On account of the applicability of executive instructions for calculating share values of private investment Companies, the assets of the family members would have registered a substantial fall for wealth tax purpose. The assessee had created a goodwill of Rs. 10 Crores which would have increased the value of shares of K.P.P.L. The increase had been got rid of by an ingenious method. The assessee created about 48 new subsidiaries. The assessee sold the shares held by it to about 22 investment Companies (subsidiaries) out of this 48. The assessee sold the share of these twenty two subsidiary investment Companies (51) to corresponding set of another twenty two subsidiaries. On account of the sale of share of the 22 Companies, they ceased to be subsidiaries of the assessee, but they became the subsidiaries of another set of subsidiaries (52). Since the sale of shares was of investment Companies, the assessee applied the instructions in Board's circular for valuation of shares of investment Companies, issued for wealth tax purpose. Since the twenty two Companies had existed for a few months, they did not earn any income. Since the income yield was nil, applying the Board's instructions, the value of the share was to be computed a half of the break up value of value based on yield which was zero since yield was nil. Hence the assessee sold the share to the subsidiaries (52) at almost half the price. On account of the sale the assessee incurred an artificial loss and

this was used to set off against the artificial increase of Rs. 10 Crores due to creation of goodwill. It is also worth noting that the assessee had taken care that it held only 99.98 to 99.9% of the shareholding so that the capital loss could be taken into account. The Assistant Commissioner also gave an illustration how the assessee floated the subsidiary investment Company called Alkapuri Investments Pvt. Ltd. and concluded that every move the assessee had been aimed at tax avoidance and tax planning and the creation of goodwill was only a part of the programme of tax avoidance and tax planning and there was, therefore, need for proper inquiry as to whether the question of goodwill had been given at an exaggerated figure. Even while holding that there was need for inquiry for purposes of ascertaining the correct figure of goodwill as accepted by the principles of accountancy, the Assistant Commissioner came to the conclusion that the inquiries conducted by the ITO were incomplete and, therefore, the Assistant Commissioner came to the conclusion that in the interest of justice the assessee should be provided with one more opportunity to furnish its estimate of the market value of assets transferred on which the profits can be taxed. The Assistant Commissioner accordingly set aside the assessment with the following directions to be observed by the ITO while reframing the assessment :-

"(i) Computation of goodwill of all the four units transferred to subsidiaries should be properly enquired into taking also into account Shri Ghatalia's report, in the light of the discussion in the appellate order.

(ii) The Income-tax Officer should re-ascertain the market value of the depreciable assets transferred and also the market values closing stock, raw materials, spare-parts, etc. as has been done in the assessments, after giving adequate opportunity. If the values are not furnished by the appellant he will be at liberty to estimate the values.

(iii) Profit u/s. 41(2) and profit on sale of raw materials, closing stock etc. should be considered as income of the appellant subject to the limit of difference between the goodwill created and the estimated goodwill by the Income-tax

Officer."

FINDINGS GIVEN BY THE TRIBUNAL

11. In second appeal before the Tribunal, there was a difference of opinion between the Judicial Member and the Accountant Member. Hence, the case was referred by the President of the Tribunal for hearing by the Vice President of the Tribunal. The Judicial Member had accepted the stand of the revenue and concluded that while it is open to the transferor to transfer the assets at less than the market value, and when the consideration for goodwill is in dispute, it is open to the revenue to show that goodwill is over valued and the other assets are undervalued. The Judicial Member relied on the decision of the Supreme Court in 85 ITR 599 wherein the Supreme Court had laid down that if circumstances exist showing that a fictitious price has been put on the asset or there is fraud or collusion between the vendor and the vendee and there has been inflation or deflation of value for ulterior purposes it is open to Income-tax Authorities not to accept the price mentioned in the deed or alleged by the assessee and to ascertain what the actual cost was. The Judicial Member concluded as under :-

"It does require investigation whether the assessee would sell and the 1004 subsidiary Company would purchase machinery, plant and furniture at the book value of the assessee and at the same time, though a losing concern, would charge for the goodwill exorbitantly. It also does require investigation whether sale price of plant and furniture in excess of book value is charged by the assessee under the guise of charging for appeal is dismissed."

However, the Accountant Member accepted the assessee's arguments that the sales in question were slump sales of the entire undertakings and that, therefore, there was no question of valuing the goodwill separately.

12. On reference, the Vice President of the Tribunal agreed with the view of the Accountant Member and in view of the said judgement dated 28.2.1991 of the Vice President, the Tribunal by its decision dated 4.1.1982 allowed the appeal of the assessee after holding that the undertakings as a whole were sold and, therefore, there was no question of assessing profits under Section 41(2)

of the Act. It was also held that the Assistant Appellate Commissioner did not have jurisdiction to direct the ITO to reframe the assessment including therein the balancing charge and profits from the sale of stocks, if any, in respect of the transaction of the sale of the Swastik Oil Mills division at Ambarnath and that even if it is assumed that he had such jurisdiction, since there was no scope for including in the total income any income by way of balancing charge under Section 41(2) and profit from the sale of stocks, spares etc. the Appellate Assistant Commissioner was not right in setting aside the assessment and requiring the ITO to reframe the assessment.

DISCUSSION

13. In view of the above controversy, the moot question is - whether the sales of the undertakings in question were slump sales or sales of individual assets. The learned counsel for the assessee has obviously tried to contend that since the agreements in question did not themselves give value of the assets which are set out in the schedules to the agreements, the principle laid down by the Apex Court in Artex Manufacturing Company (1997) 227 ITR 260 would not apply, but the principle laid down by the Apex Court in Electric Control Gear Mfg. Co., (1997) 227 ITR 278 would apply.

14. We are unable to accept this contention because in Artex Mfg. Co. (Supra), the Apex Court has held that even if in the agreement there is no reference to the value of the plant, machinery and dead stock, if on the basis of the information that is made available to the ITO, it becomes evident that the plant, machinery and dead stock was sold at a price higher than the book value of the plant, machinery and dead stock, the provisions of Section 41(2) of the Act are applicable. The facts in Artex Mfg. Co. were particularly as under :-

The assessee was a firm which was carrying on the business of manufacturing art silk cloth. A private limited Company by the name of A was formed with a view to take over the business of the assessee as a running concern. On March, 31, 1996, the assessee and the company entered into an agreement whereunder the assessee agreed to sell to the company the business hitherto carried on by the assessee as a whole going concern. The consideration for the sale was Rs.11,50,400 which was paid and satisfied by allotment of 11,504 fully paid up equity shares of Rs.100 each according to the original shares of the partners of the assessee. In pursuance of

the agreement, the assessee ceased to carry on the business with effect from April 1, 1966, and the said business stood transferred to the company. In respect of the assessment year 1967-68, the assessee filed its return showing 'nil' income. On January 9, 1970, a revised return was filed showing 'nil' income, with a note, that since the partnership firm was converted into a private limited company as a going concern, there was no income chargeable to tax either under section 41(2) or under section 45 of the Income-tax Act, 1961. During the course of the assessment proceedings before the Income-tax Officer, for the purpose of determination of the purchase consideration, the assets were shown at Rs.41,73,973 out of which the plant, machinery and dead stock, as revalued by H was Rs.15,87,296. The liabilities were shown at Rs.30,23,573 and the balance amount of Rs.11,50,400 was shown as the purchase consideration. The written down value of plant, machinery and dead stock, according to the assessee's books, was Rs.4,36,896. The difference between Rs.15,87,296, the value of plant, machinery and dead stock as revalued, and Rs.4,36,896, the written down value of plant, machinery and dead stock, according to the assessee's books, came to Rs.11,50,400. The Income-tax Officer held that the written down value of plant, machinery and dead stock according to the income-tax records was Rs.3,32,276. After deducting the same from the amount of Rs.15,87,296 for which the plant, machinery and dead stock were transferred to the company, the Income-tax Officer held that tax was payable under section 41(2) on the income of Rs.12,56,020. The Tribunal held that the surplus was taxable as business profit under section 41(2) and that the assessee was assessable in the status of a registered firm. On a reference, the High Court held that Section 41(2) was not applicable. On appeal by the revenue to the Supreme Court, it was held that in the agreement of sale, there was no reference to the value of the plant, machinery and dead stock. But on the basis of the information that was furnished by the assessee before the Income-tax Officer it became evident that the amount of Rs.11,50,400 had been arrived at by taking into consideration the value of the plant, machinery and dead stock as assessed by the valuer at Rs.15,87,296. Section 41(2) was applicable. It was further held that the liability under section 41(2) was limited to the amount of surplus to the extent of the difference between the written down value and the actual cost. If the amount of surplus exceeded the difference between the written down value and the actual cost, then the surplus amount to the extent of such excess would have to be treated as capital gains for the

purpose of taxation. The Tribunal had not considered this matter. It was held that on the question relating to the two circulars of the Central Board of Direct Taxes, the Tribunal had stated that one of the circulars related to the tax liability of surplus in the case of nationalized banks and it has no application to the present case and that the second circular was based on the decision in Mugneeram Bangur (1965) 57 ITR 299 (SC), and since the said case dealt with the provisions of section 10(2)(vii), proviso (ii), of the 1922 Act prior to amendment, the said circular has no application and that the matter was governed by the decision in B.M. Kharwar (1969) 72 ITR 603 (SC). The view of the Tribunal was correct.

In view of the above decision, reliance placed on behalf of the assessee on the circulars of the Central Board of Direct Taxes is clearly misconceived.

15. In view of the aforesaid decision, we are of the view that the Appellate Assistant Commissioner was fully justified in remanding the matter to the ITO for determining the correct valuation of the goodwill as the goodwill determined by the assessee was at an exaggerated figure for the loss making undertakings. Since the order of the Appellate Assistant Commissioner was only an order of remand requiring the ITO to determine the value of the goodwill by applying the correct principles of accountancy, there was no warrant for the Tribunal to interfere with the said order. Moreover, even if the assessee was not in a position to give the particulars about the market value of various assets, it was certainly open to the assessee to point out the actual cost of the assets and the difference between the written down value and the actual cost was liable to be taxed as balancing charge under Section 41(2).

16. We have not gone into details of the valuation made by the ITO as the question is left open by the Appellate Assistant Commissioner for determining the correct value of the goodwill.

17. We may point out that the principle in Electric Control Gear Mfg. Co. is not applicable. The facts in the said case were as under :-

The assessee was a partnership concern consisting of 13 partners. On March 31, 1966, it entered into an agreement whereby it transferred the entire assets of the business together with the liabilities as a going concern

to a limited company, for a consideration of Rs. 8 lakhs. The erstwhile partners of the assessee firm were allotted share in the company of the same value in their profit sharing proportion. The Income-tax Officer held that depreciation allowed to the assessee firm amounting to Rs.3,32,863 in respect of the assets transferred by the firm to the said company, was chargeable to tax under the provisions of Section 41(2) of the Income-tax Act, 1961. He also brought to tax capital gains of Rs. 8 lakhs, being the sum of Rs. 5,000 as basic exemption, included the sum of Rs.7,95,000 in the computation of the total income of the assessee under the head "Capital gains". The Appellate Assistant Commissioner held that the profits in question were taxable under the provisions of section 41(2). The Tribunal remitted the matter to the Income-tax Officer for recomputation of the aggregate amount chargeable as profits under Section 41(2) and as capital gains. The High Court held that section 41(2) was not applicable. On appeal by the revenue to the Supreme Court, the Supreme Court held that there was nothing to indicate the price attributable to the assets like machinery, plant or building out of the consideration amount of Rs. 8 lakhs. Merely because a sum of Rs.3,32,863 had been allowed as depreciation to the assessee firm, it could not be said, that was the excess amount between the price and the written down value. The provisions of Section 41(2) were not applicable.

It is thus clear that the consideration amount in the said case was only Rs. 8 lakhs as the cost of the total undertaking and the decision was rendered on the peculiar facts of the said case. The Court held that there was nothing to indicate the price attributable to the assets like machinery, plant or building was out of the consideration amount of Rs.8 lakhs and merely because a sum of Rs.3,32,863 had been allowed as depreciation to the assessee firm, it cannot be said that that was the excess amount between the price and the written down value. In the present case, however, the facts are too glaring to fall within the four corners of Electric Control Gear Mfg. Co. As rightly noted by the ITO and the Appellant Assistant Commissioner, when the undertakings in question like Swastik Oil Mills were incurring huge losses, its units could not have been sold at a price of Rs.2.45 Crores when the written down value of its assets other than goodwill was only about Rs. 45 lakhs meaning thereby Rs. 2 Crores could not have been the value of the goodwill for the Ambarnath unit of the said undertaking. Similarly, the Wadala unit of Swastik

Oil Mills division was sold by the assessee to its newly floated wholly owned subsidiary Vegoil (Pvt) Ltd. for a consideration of Rs. 1 Crore which had the following break up :-

Particulars	Amount (Rs.)
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Land, building, plant & machinery	14,00,000/-
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Technical know-how	10,00,000/-
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Goodwill	76,00,000/-
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Even the said amount of Rs.76 lakhs has been found to be an exaggerated figure as per the concurrent findings given by the ITO and the AAC.

18. In view of the aforesaid facts, we are satisfied that the order of remand passed by the Appellate Assistant Commissioner did not warrant any interference at the hands of the Tribunal.

19. As regards the contention of Mr Patel for the assessee that the actual machinery for computation would fail in arithmetical terms.

We are unable to accept the said contention. If the difference between the actual cost and the written down value of the assets is taxable under Section 41(2), the same will have to be taxed. The decision of the Supreme Court in Sunil Siddharthbhai vs. CIT, (1985) 156 ITR 509 pertained to consideration which a partner acquires on making over his personal asset to the firm as his contribution to its capital. The facts in the instant case are entirely different. Hence, the principle laid down therein is not applicable.

20. Before concluding, we must note that even while not accepting the major arguments urged on behalf of the assessee, there is some substance in the contention of Mr RK Patel for the assessee that the provisions of section 41(2) govern only building, machinery, plant or furniture and that, therefore, other assets cannot be included within the scope of Section 41(2) for taxing the difference between the written down value and the actual cost. We also find that in view of the provisions of Section 47 of the Act, transfer will not attract the provisions of Section 45 relating to capital gains if the transfer of capital assets is by a Company to its wholly owned subsidiary Company and the holding Company as well

as the subsidiary Company are Indian Companies.

21. In view of the above discussion, our answer to question No. 1 is in the negative to the above extent i.e. in favour of the revenue and against the assessee. Our answer to question No. 2 is in the affirmative to the above extent i.e. in favour of the revenue and against the assessee.

The references accordingly stand disposed of with no order as to costs.

(D.M. Dharmadhikari, CJ)

(M.S. Shah, J.)

sundar/-